

Name: _____

I. Multiple Choice

1. The two cornerstones of classical economics are ____.
 - A. The Phillips Curve and Say's Law
 - B. Say's Law and the Quantity Theory of Money
 - C. The Quantity Theory of Money and the Liquidity Preference Theory
 - D. Say's Law and the Liquidity Preference Theory

2. Which of the following statements is *inconsistent* with Say's Law?
 - A. The economy has flexible wages and prices
 - B. The economy's level of investment spending depends solely on the level of income.
 - C. The economy will produce at the full-employment level of output.
 - D. The economy has an environment of "laissez faire."

3. In classical theory, interest rates are determined ____.
 - A. by the price level and unemployment
 - B. strictly by the money supply
 - C. by the supply and demand for money
 - D. by saving and investment

4. In the classical view, the price level is determined by ____.
 - A. aggregate supply
 - B. aggregate demand and supply
 - C. supply of money
 - D. aggregate demand

5. In an economy operating at full employment with constant velocity of 6, an increase in the money supply of 4% will cause ____.
 - A. the price level to rise by 24%
 - B. output to rise by 4%
 - C. output to rise by 24%
 - D. the price level to rise by 4%

6. In the classical model, the aggregate supply curve determines the ____.
 - A. money supply
 - B. inflation rate
 - C. level of output
 - D. price level

7. Which of the following ensures full employment in the classical model?
 - A. the equation of exchange
 - B. wage and price flexibility
 - C. a constant velocity
 - D. inventory adjustment

8. If the inflation rate is 5% and the real rate of interest is 3%, the nominal interest rate is ____.
- A. 15%
 - B. 5%
 - C. 8%
 - D. 3%
9. In the simple Keynesian framework, the price level ____.
- A. varies inversely with wages
 - B. is fixed
 - C. is indeterminate
 - D. varies directly with unemployment
10. In explaining the level of unemployment, Keynes emphasized ____.
- A. changes in technology
 - B. aggregate demand
 - C. inflationary expectations
 - D. lending by financial institutions
11. Assume a consumption function of the following form: $C = 50 + .8Y$. If income is equal to \$1,000, then consumption is ____.
- A. \$50
 - B. \$1,050
 - C. \$1,000
 - D. \$850
12. In an economy with \$100 taxes, an income level of \$600, consumption of \$400, and government spending of \$25, investment is equal to ____.
- A. \$75
 - B. \$175
 - C. \$100
 - D. \$200
13. In the Keynesian model, an increase in government spending increases ____.
- A. the money supply by an equal amount
 - B. the money supply by a multiple amount
 - C. aggregate demand by a multiple amount
 - D. aggregate demand by an equal amount
14. In the Keynesian model, liquidity preference refers to the ____.
- A. demand for consumer goods
 - B. demand for capital
 - C. the supply of money
 - D. demand for money

15. An increase in the money supply in the simple Keynesian model causes interest rates to fall because ____.
- A. demand for capital goods increases
 - B. consumer demand for goods and services increases
 - C. demand for bonds increases
 - D. demand for bonds decreases
16. In terms of the aggregate demand and supply framework, a decrease in the money supply will shift aggregate ____.
- A. demand to the left
 - B. supply to the right
 - C. supply to the left
 - D. demand to the right

II. Short Answer

17. If, contrary to Classical theory, the interest rate does not fall to eliminate an excess of saving over investment and if prices and wages do not fall as unsold goods pile up, how does the economy adjust to correct for this disequilibrium, according to Keynes? *Please include a graph with your explanation.*

18. Consider a simple economy in which whole investment is constant and equal to \$50 billion. There are no government or foreign sectors, and the price level is constant. Assume that consumption behavior can be described as $C = \$40 \text{ billion} + .8Y$.

A. What is the value of the marginal propensity to consume?

B. What would be the value of consumption if $Y = \$500 \text{ billion}$?

C. What is the equilibrium level of GDP in this model? Verify your answer by showing that savings equals investment in equilibrium (*include a graph with your explanation please*).

D. What is the value of the multiplier in this model? What determines the size of the multiplier?

E. Suppose that desired investment were to call to \$40 billion. What would happen to equilibrium income?